

Evaluation

Report



DISTRIBUTION STATEMENT A
Approved for Public Release
Distribution Unlimited

**STRATEGIC AND CRITICAL MATERIALS IN THE
DEFENSE NATIONAL STOCKPILE**

Report No. 99-044

December 3, 1998

Office of the Inspector General
Department of Defense

DTIG QUALITY INSPECTED 4

19990907 159

AQI 99-12-2219

INTERNET DOCUMENT INFORMATION FORM

A . Report Title: Strategic and Critical Materials in the Defense National Stockpile

B. DATE Report Downloaded From the Internet: 09/07/99

C. Report's Point of Contact: (Name, Organization, Address, Office Symbol, & Ph #):
OAIG-AUD (ATTN: AFTS Audit Suggestions)
Inspector General, Department of Defense
400 Army Navy Drive (Room 801)
Arlington, VA 22202-2884

D. Currently Applicable Classification Level: Unclassified

E. Distribution Statement A: Approved for Public Release

F. The foregoing information was compiled and provided by:
DTIC-OCA, Initials: VM **Preparation Date** 09/07/99

The foregoing information should exactly correspond to the Title, Report Number, and the Date on the accompanying report document. If there are mismatches, or other questions, contact the above OCA Representative for resolution.

Additional Information and Copies

To obtain additional copies of this evaluation report, contact the Secondary Reports Distribution Unit of the Analysis, Planning, and Technical Support Directorate at (703) 604-8937 (DSN 664-8937) or FAX (703) 604-8932 or visit the Inspector General, DoD, Home Page at: www.dodig.osd.mil.

Suggestions for Evaluations

To suggest ideas for or to request future evaluations, contact the Planning and Coordination Branch of the Analysis, Planning, and Technical Support Directorate at (703) 604-8908 (DSN 664-8908) or FAX (703) 604-8932. Ideas and requests can also be mailed to:

OAIG-AUD (ATTN: APTS Evaluation Suggestions)
Inspector General, Department of Defense
400 Army Navy Drive (Room 801)
Arlington, Virginia 22202-2884

Defense Hotline

To report fraud, waste, or abuse, contact the Defense Hotline by calling (800) 424-9098; by sending an electronic message to Hotline@dodig.osd.mil; or by writing to the Defense Hotline, The Pentagon, Washington, D.C. 20301-1900. The identity of each writer and caller is fully protected.

Acronyms

AMP	Annual Materials Plan
DLA	Defense Logistics Agency
DNSC	Defense National Stockpile Center
EPA	Environmental Protection Agency
GPRA	Government Performance and Results Act
LDT	Long Dry Tons
MIC	Market Impact Committee
NPR	National Performance Review
OMB	Office of Management and Budget



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202

December 3, 1998

MEMORANDUM FOR DEPUTY UNDER SECRETARY OF DEFENSE
(INDUSTRIAL AFFAIRS AND INSTALLATIONS)
DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: Evaluation Report on Strategic and Critical Materials in the Defense National Stockpile (Report No. 99-044)

We are providing this report for information and use. We considered management comments on a draft of this report when preparing the final report.

The Deputy Under Secretary of Defense (Industrial Affairs and Installations) and Defense Logistics Agency comments conformed to the requirements of DoD Directive 7650.3; therefore, additional comments are not required.

We appreciate the courtesies extended to the evaluation staff. Questions on the evaluation should be directed to Mr. Raymond Kidd at (703) 604-8828 (DSN 664-8828), e-mail rkidd@dodig.osd.mil, or Mr. Al Putnam at (703) 604-8779 (DSN 664-8779), e-mail aputnam@dodig.osd.mil. See Appendix I for the report distribution. The evaluation team members are listed inside the back cover.

A handwritten signature in cursive ink that reads "David K. Steensma".

David K. Steensma
Deputy Assistant Inspector General
for Auditing

Office of the Inspector General, DoD

Report No. 99-044

(Project No. 8LH-0001)

December 3, 1998

Strategic and Critical Materials in the Defense National Stockpile

Executive Summary

Introduction. The Strategic and Critical Materials Stockpiling Act of 1979, which continued policy from World War II, requires the stockpiling of certain strategic and critical materials to preclude, where possible, a dangerous and costly dependence by the United States on foreign sources for supplies of such materials in times of national emergency. The Defense National Stockpile Center (DNSC), a Defense Logistics Agency organization, manages the day-to-day operations of the current inventory of 88 stockpiled materials with an estimated market value of \$5.3 billion. In 1997, more than 99 percent of the Defense National Stockpile was declared excess to the needs of DoD. The decreased need for stockpiling strategic and critical materials prompted Congress to authorize the sale of specific quantities of selected materials each year. As a National Performance Review High Impact Agency, DoD set a goal of disposing of \$2.2 billion in excess stockpiled materials by the year 2000. DoD incorporated the goal into its Government Performance and Results Act plan.

Evaluation Objectives. The evaluation objective focused on management controls over the disposition of stockpiled materials. Our specific objectives were to evaluate the effectiveness of the DNSC sales contracting and disposal plans and procedures for reducing the stockpile inventory. We also reviewed the adequacy of the management control program as it applied to the evaluation objectives.

Evaluation Results. The overall DNSC management of the disposition of stockpile material was effective, especially regarding sales of the top 15 high demand materials. Nevertheless, sales for 35 of 50 materials with restricted or limited markets and approved Annual Materials Plans could be improved. Furthermore, actions to reduce the stockpile inventory by means other than sales could be improved. Under current procedures, the DNSC ability to sell or otherwise dispose of unneeded stockpiled materials was not optimized and the costs for maintenance and storage of those unneeded stockpiled materials were not abated as much as possible (Finding A).

The annual DoD "Strategic and Critical Materials Report to Congress" (the Report) needed revision in order to provide a complete and accurate summary of DNSC operations. As a result, congressional oversight committees and senior DoD management could not fully rely on the information presented in the Report for decisionmaking and performance evaluation (Finding B).

The DNSC management controls that we reviewed in sales contracting were adequate. See Appendix A for a discussion of the management control program and Appendix C for a discussion of the evaluation of the DNSC sales contracting operation.

Summary of Recommendations. We recommend that the Director, Defense Logistics Agency, direct the Administrator, DNSC, to set annual goals for achieving a higher volume of sales for stockpiled materials with restricted or limited markets and approved Annual Materials Plans. To facilitate reductions in stockpiled materials, we recommend the establishment of comprehensive disposal plans that include aggressive sales strategies and the use of trend analyses and annual decision points, all geared to determining if disposal by other than sales is desirable. Further, we recommend that the Deputy Under Secretary of Defense (Industrial Affairs and Installations) and the Director, Defense Logistics Agency, establish guidance on the preparation of the Report.

Management Comments. The Deputy Under Secretary of Defense (Industrial Affairs and Installations) concurred with the recommendations and requested the Defense Logistics Agency to develop specific guidance for the Report in the eight areas recommended in this report. The Defense Logistics Agency concurred with all recommendations and stated that DNSC would establish requirements to set annual goals and to develop comprehensive disposal plans. Further, the Defense Logistics Agency will work with the Deputy Under Secretary of Defense (Industrial Affairs and Installations) to develop additional guidance on the preparation of the Report. Finally, the Defense Logistics Agency stated that DNSC has requested full funding of all known environmental liability costs in the Defense Logistics Agency Budget Estimate Submission. See Part I for the complete discussion of management comments and Part III for the complete text of management comments, including DNSC clarifications to the recommendations.

Table of Contents

Executive Summary	i
--------------------------	---

Part I - Evaluation Results

Evaluation Background	2
Evaluation Objectives	3
Finding A. Sales and Disposal of Stockpiled Materials With Restricted or Limited Markets	4
Finding B. Reporting of DNSC Operations to Congress	12

Part II - Additional Information

Appendix A. Evaluation Process	
Scope	24
Methodology	24
Management Control Program	25
Appendix B. Summary of Prior Coverage	27
Appendix C. Other Matters of Interest	29
Appendix D. Factors Influencing Stockpile Operations	32
Appendix E. National Defense Stockpile Composition	34
Appendix F. Market Effects on Stockpile Value	36
Appendix G. National Defense Stockpile--Cash Projection	37
Appendix H. Environmental Liabilities	38
Appendix I. Report Distribution	39

Part III - Management Comments

Deputy Under Secretary of Defense (Industrial Affairs and Installations)	
Comments	42
Defense Logistics Agency Comments	44

Part I - Evaluation Results

Evaluation Background

The Strategic and Critical Materials Stockpiling Act (the Act) of 1979 continued policy from World War II requiring that a stock of strategic and critical materials be maintained. The purpose of the Act was to "provide for the acquisition and retention of stocks of certain strategic and critical materials and to encourage the conservation and development of sources of such material within the United States and thereby to decrease and preclude, where possible, a dangerous and costly dependence by the United States upon foreign sources for supplies of such materials in times of national emergency."

In 1997, the mobilization planning and war scenario assumptions developed by the Joint Staff and the Office of the Secretary of Defense indicated that of 88 materials in the National Defense Stockpile (the stockpile) only 6, with an estimated market value of \$43.9 million, were required to be retained. The classification of materials as strategic and critical changes over time as underlying assumptions, new technology, and warfighting scenarios dictate the obsolescence of materials. Thus, in the view of DoD, 99 percent of the existing stockpiled materials, valued at \$5.3 billion, became excess to the needs of the U.S. Government. Storage costs are about \$24.4 million annually. As a National Performance Review (NPR) High Impact Agency, DoD set a goal to dispose of \$2.2 billion in excess stockpiled materials by the year 2000. DoD incorporated the goal into its Government Performance and Results Act (GPRA) plan.

Organizational Responsibilities. Several DoD staff elements and organizations play important roles in Defense National Stockpile Center (DNSC) operations. Brief descriptions of those roles follow.

Under Secretary of Defense (Comptroller). The Under Secretary of Defense (Comptroller) ensures that planned and actual financial commitments assessed against the stockpile can be supported by anticipated revenues and cash balances on hand.

Deputy Under Secretary of Defense (Industrial Affairs and Installations). The Deputy Under Secretary of Defense (Industrial Affairs and Installations) develops policy and monitors the operations of various Government programs and processes affecting industry. Such programs and policies include the stockpile. The Office of the Deputy Under Secretary of Defense (Industrial Affairs and Installations), in coordination with the Joint Staff, determines which materials are strategic and critical and the quality and quantity of each material to be stockpiled.

Defense Logistics Agency. The Defense Logistics Agency (DLA) is the parent organization of DNSC. DLA reviews actions taken by the Administrator, DNSC, in performing day-to-day operations. The Administrator, DNSC, oversees the operational aspects of acquisitions and disposals.

Approval Process for Sales of Stockpiled Materials. The current DNSC focus is to reduce the stockpile and meet the GPRA goal; however, DoD must make maximum feasible efforts to avoid an undue market disruption. DNSC requests disposal authority from Congress for each stockpiled material determined by DoD to be excess. Once disposal authority is received from Congress, DNSC prepares an Annual Materials Plan (AMP) for each material, which lists the maximum amount that DNSC would be permitted to sell under ideal market conditions. The AMPs are submitted to an interagency Market Impact Committee (MIC), which reviews and frequently recommends changes in disposal levels. The MIC, composed of various Federal and industry representatives, advises DNSC on the projected domestic and foreign market effects of the stockpile disposals detailed in the AMPs. Stockpile sales are not permitted until Congress has reviewed and approved each AMP. See Appendix D for a discussion of factors influencing stockpile operations.

Evaluation Objectives

The evaluation objective focused on management controls over the disposition of stockpiled materials. Our specific objectives were to evaluate the effectiveness of the DNSC sales contracting and disposal plans and procedures for reducing the stockpile inventory. See Appendix A for a discussion of the evaluation scope and methodology and the management control program. See Appendix B for a summary of prior coverage related to the objectives. Details of our review of the DNSC A-76 review and sales contracting operation are in Appendix C.

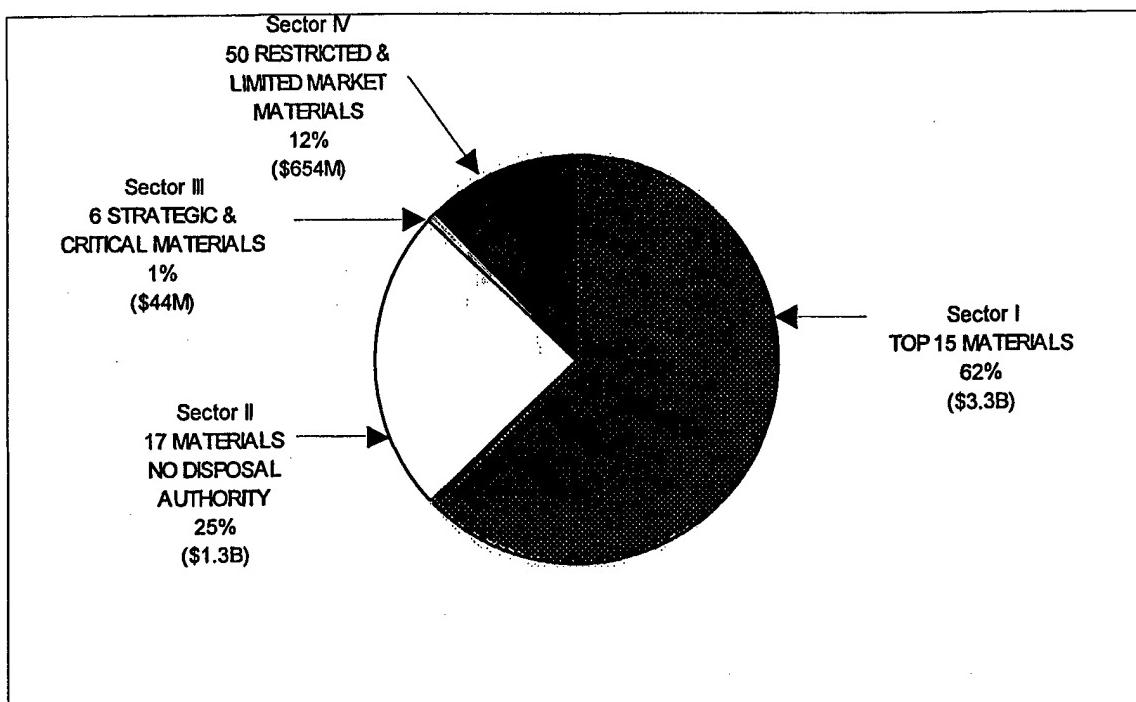
Finding A. Sales and Disposal of Stockpiled Materials With Restricted or Limited Markets

The overall DNST management of stockpiled materials was effective, especially for sales of the top 15 high demand materials. However, to achieve even greater inventory reduction, DNST could improve its sales and disposal processes. Specifically, DNST commodity sales teams did not maximize sales for 35 of 50 materials with restricted or limited markets and approved AMPs. In addition, opportunities exist to reduce the stockpile inventory by means other than sales. Inventory reduction was not yet maximized because DNST had not developed comprehensive disposal plans, to include sales and other methods, for stockpiled materials. As a result, the DNST ability to sell or otherwise dispose of unneeded stockpiled materials was not optimized and the costs for maintenance and storage of those unneeded stockpiled materials were not abated as much as possible.

Sales and Disposal of Stockpiled Materials--An Overview

The stockpile, which had a market value of \$5.3 billion as of September 30, 1997, consists of an inventory of 88 items such as metals, minerals, and ores. In the view of DoD, as set forth in the "1997 Report to the Congress on National Defense Stockpile Requirements," June 1997, more than 99 percent of the stockpile has become excess to national security needs, and \$4 billion (75 percent) has been authorized by Congress for sale or disposal. However, Congress has not officially accepted the DoD position with respect to 17 materials and so has not yet authorized their sale. Revenues from sales of excess materials pay for the operation of DNST, are accumulated for DoD projects, and are transferred to the Services through the budget process. Since FY 1993, \$1.3 billion has been transferred to the operating accounts of the Services. The FY 1999 DoD budget requires the transfer of an additional \$1.25 billion from FY 1999 through FY 2003. The following graph shows the composition and value of the stockpile, with dollar value and percentage of the stockpile market value.

Finding A. Sales and Disposal of Stockpiled Materials With Restricted or Limited Markets



Composition and Value of the Stockpile (as of September 30, 1997)

Sector I is composed of the top 15 selling materials, including cobalt, tin, and zinc, which account for most of the revenues generated from the sale of stockpiled materials. Sector II is composed of 17 materials, including chromium, platinum, and tungsten, for which Congress has not given disposal authority. Sector III is composed of 6 materials (1 percent of the stockpile composition) that are classified by DoD as strategic and critical. Those materials--beryllium, iridium, mica, palladium, quartz, and refractory bauxite--are, in the view of DoD, the only materials that require stockpiling. Sector IV is composed of 50 materials with restricted or limited markets (lesser demand materials), including graphite, mercury, and talc. A detailed discussion of the stockpile composition is given in Appendix E.

Overall Management of Stockpiled Materials

The overall DNSC management of stockpiled materials was effective, especially for sales of the top 15 high demand materials. Since 1993, DNSC has met the financial commitments assessed against sales of excess stockpiled materials primarily through the sale of the top 15 high demand materials: materials with a strong demand in the private sector that bring fair prices when sold. DNSC does not need to change the manner in which those materials are sold.

Finding A. Sales and Disposal of Stockpiled Materials With Restricted or Limited Markets

As a NPR High Impact Agency, DoD established a goal to reduce the value of the stockpile by \$2.2 billion by the year 2000. The goal is planned to be achieved through sales from FY 1997 through FY 2000. DNSC achieved sales of \$513 million in FY 1997 toward the goal. Because the goal is defined in terms of the dollar value, the goal could be achieved solely by sales of the top 15 high demand materials in Sector I, which have a market value of \$3.3 billion as of September 30, 1997. Accordingly, the goal does not reflect a proportionate reduction in the excess materials in the stockpile inventory. Furthermore, it is important to note that the value of the stockpile inventory varies with market price fluctuations. For example, the market value of the stockpile inventory declined over \$300 million in the 3 years between September 1993 and October 1996, notwithstanding actual sales of stockpiled materials of about \$1.6 billion during the same period. That anomaly is accounted for by wide swings in commodity prices during those years. Cobalt, as a significant measurable example, went from less than \$10 per pound to nearly \$30 per pound due to civil war in Zaire at a time when the stockpile had more than 40 million pounds of cobalt in inventory.

DNSC Disposal Plans

DNSC can improve its sales and disposal processes by developing a comprehensive disposal plan for each stockpiled material, to include sales and other methods, with an emphasis on lesser demand materials. Specifically, a comprehensive disposal plan would include:

- o an aggressive sales strategy and
- o a cost benefit analysis, periodic trend analyses, and annual decision points, to determine if disposal by other than sales was desirable.

By selling more lesser demand materials, DNSC will also achieve a more proportionate reduction in the excess materials in the stockpile inventory.

The DNSC Sales Handbook (the Handbook), Subchapter B, Part 9000.7, "Strategic Plans and Sales Plans," March 25, 1997, established guidance for the sale of stockpiled materials. The Handbook requires that DNSC personnel complete an Annual Sales Plan for each material with an approved AMP and that they review and update the Strategic Master Plan. The Strategic Master Plan depicts the overall strategy for managing the sale of a stockpiled material until it is completely sold out of the stockpile inventory. It is shaped by Annual Sales Plans developed by DNSC commodity sales teams to identify the specific sales strategy for a given fiscal year governing the sale of a material with an approved AMP. Generally, the Annual Sales Plan is required to be completed by October 1

Finding A. Sales and Disposal of Stockpiled Materials With Restricted or Limited Markets

of each fiscal year unless an industry meeting is planned. The Annual Sales Plan is then used to update the Strategic Master Plan. Each Annual Sales Plan is unique, depending on the intricacies of the material. However, the basic categories include materials with approved AMPs, quantity offered for sale, why the material was selected, uses of the material, how the material is packaged, method of sale, special circumstances, sales history, and contractor performance.

DNSC Aggressive Sales Strategy

Procedures for the DNSC commodity sales teams did not include aggressive sales strategies for disposing of lesser demand materials with approved AMPs. Emphasis was on sales of the top 15 high demand materials with a ready market to achieve sales dollar goals, while sales of lesser demand materials were not emphasized. During FY 1997, of the total sales of \$513.2 million, sales of the top 15 high demand materials (Sector I) were about \$454.1 million and sales of lesser demand materials (Sector IV) were \$59 million. Further analysis of the sales of lesser demand materials showed that 15 of those materials accounted for \$53.3 million and 35 materials accounted for \$5.7 million in sales.

Of the 50 lesser demand materials, sales efforts could be improved for 35 of those materials because DNSC sales averaged less than 40 percent of each material's respective AMP. DNSC did not establish goals or procedures and did not use a proactive approach to sell a greater portion of the lesser demand materials with approved AMPs. To assess the effectiveness of the DNSC sales teams' efforts, we examined 30 of the 35 lesser demand materials that had an approved AMP and had generated less than \$1 million in annual sales for FY 1997. Table 1 shows the quantities of materials and percentage of sales achieved in comparison with the approved AMP.

Table 1. FY 1997 AMP Sales for 35 Sector IV Materials

<u>Number of Materials Sold</u>	<u>Percentage of AMP Sold</u>	<u>Total Sales</u>
4	100	\$1,055,752
1	53	279,300
3	30-40	1,196,528
3	20-29	1,395,794
2	10-19	847,310
<u>22</u>	<u><10</u>	<u>925,342</u>
Total	35	\$5,700,026

Finding A. Sales and Disposal of Stockpiled Materials With Restricted or Limited Markets

Table 1 shows that 22 of 35 materials (63 percent) sold had sales that were less than 10 percent of their allowed AMPs. The volume of sales for stockpiled materials with approved AMPs could have been higher if the DNSC procedures required more aggressive market research and market development for lesser demand materials.

An example of the effectiveness of aggressive marketing strategies is the sale of 24,620 pounds of morphine sulfate powder. DNSC entered into an agreement with Noramco, a pharmaceutical manufacturer, to broker the sale of stockpiled morphine sulfate powder to several purchasers. The agreement permitted DNSC to realize a sale of \$5.3 million for aging morphine that would have become useless but continue to incur maintenance and storage costs.

DNSC Disposal Methods Other Than Sales

DNSC can improve its disposal process not only by having an aggressive sales strategy, but also by using cost benefit analyses, periodic trend analyses, and annual decision points, designed to determine if disposal by methods other than sales was desirable. Through such analyses and disposition of materials, the costs for maintenance and storage of those materials could be abated. DNSC had no guidance requiring methods of disposal other than sales. Other methods should be considered, such as abandonment of materials, landfill disposition, incineration, and donation.

The costs for maintenance and storage of stockpiled materials represent a significant portion of the DNSC operating budget. Although the maintenance portion was not readily available, the DNSC operating budget included \$24.4 million (about 50 percent of the operating budget) for the lease costs associated with the storage of stockpiled materials. For example, DNSC stored 4,145,975 long dry tons (LDT) of surinam bauxite on eight properties it leased at a cost of \$2.7 million (see Table 2).

**Finding A. Sales and Disposal of Stockpiled Materials
With Restricted or Limited Markets**

Table 2. Location and Storage of Surinam Bauxite

<u>Storage Site</u>	<u>Site Owner</u>	<u>Quantity (LDT)</u>	<u>Rent Per Year</u>
Anniston, AL	Army	353,274	\$ 346,348
Granite City, IL	Army	339,526	581,472
Gregory, TX	Reynolds ¹	656,275	102
Gulfport, MS	Navy	1,091,221	986,603
Huntsville, AL	Army	29,653	95,625
Pine Bluff, AR	Army	8,437	84,000
Texarkana, TX	DLA	326,137	601,088
Theodore, AL	GSA ²	<u>1,341,452</u>	<u>0</u>
Total		4,145,975	\$2,695,238

¹ Reynolds Aluminum

² General Services Administration

Although the surinam bauxite at all 8 sites was offered for sale in FY 1997, only the 656,275 LDT held at Gregory, Texas, was bid on and sold to ALCOA aluminum for \$7.9 million. Storage costs of \$2.7 million were incurred at the other seven sites storing surinam bauxite because none of those sites had sales in FY 1997. Such a situation indicates a need for cost benefit and trend analyses.

Cost Benefit Analyses. DNSC needed to conduct cost benefit analyses that consider anticipated revenues from sales versus annual maintenance and storage costs. The costly storage sites for surinam bauxite and other materials should not be ignored, especially when very few buyers bid on the stockpiled material. DNSC should develop a disposal plan that includes a cost benefit analysis for each excess stockpiled material. If the stockpiled material cannot be depleted in a timely manner and there are maintenance and storage costs, then DNSC should explore other possible disposal methods. For surinam bauxite, DNSC needed to consider alternative disposal methods, such as donating the excess material to State governments, which could use it as roadfill. That way, DNSC would deplete its excess surinam bauxite and avoid storage costs.

Trend Analyses and Annual Decision Points. The disposal plan should include periodic trend analyses and annual decision points to ensure that the most effective disposal method was used for each stockpiled material. Once a determination was made that neither anticipatory nor past revenues generated

Finding A. Sales and Disposal of Stockpiled Materials With Restricted or Limited Markets

from sales compared favorably to the maintenance and storage costs of a material or that no market exists, then DNSC needed to convert to a disposal plan that included disposal strategies other than sales.

A good candidate for such an analysis is the stockpiled material quinidine sulfate. The stockpile of 2.4 million avoirdupois ounces of quinidine sulfate, depleted at the expected FY 1998 sales rate of 60,000 avoirdupois ounces per year, will result in DNSC managing that stockpiled material for 40 years. The annual storage costs are \$9,035. Assuming a direct proportion between storage costs and materials on hand, DNSC will incur about \$180,000 in storage costs while depleting the stockpile for this material (provided a sales market still exists). Buyers for quinidine sulfate are disappearing, and that is a concern to the MIC, especially if the trend of decreasing demand continues. DNSC needed to either develop a new market or a disposal plan other than through sales for quinidine sulfate, depending on the results of a trend analysis.

Periodic trend analyses should be performed on all stockpiled materials and if a determination is made that a limited market or no market exists for a material, convert it to a disposal plan that includes disposal strategies other than sales. Further, annual decision points should be established that determine if continued sales or rapid disposal of a stockpiled material is more cost-effective and in the best interest of the Government.

Summary

The overall DNSC management of the 88 stockpiled materials was effective, especially regarding its performance on sales of the top 15 high demand materials. However, improvements were needed in its efforts to maximize the sales for 35 of 50 excess stockpiled materials with lesser demand and approved AMPs. DNSC needed to develop comprehensive disposal plans to include sales and other than sales for each of the stockpiled materials. Such actions would assist DNSC in achieving a more proportionate inventory reduction and reducing storage costs.

Recommendations and Management Comments

A. We recommend that the Director, Defense Logistics Agency, direct the Administrator, Defense National Stockpile Center, to establish requirements to set annual goals to achieve a higher volume of sales for stockpiled

**Finding A. Sales and Disposal of Stockpiled Materials
With Restricted or Limited Markets**

materials with restricted or limited markets and approved Annual Materials Plans and to develop comprehensive disposal plans. At a minimum, the disposal plans should include:

- 1. An aggressive sales strategy with annual goals to achieve a higher volume of sales for stockpiled materials with restricted or limited markets and approved Annual Materials Plans.**
- 2. A cost benefit analysis, periodic trend analysis, and annual decision points, to determine if disposal by other than sales was desirable.**

Defense Logistics Agency Comments. DLA concurred, stating that DNSC will establish requirements to set annual goals to achieve a higher volume of sales for stockpiled materials and develop comprehensive disposal plans by November 30, 1998. DLA comments included clarifying comments submitted by DNSC.

Finding B. Reporting of DNSC Operations to Congress

The annual DoD “Strategic and Critical Materials Report to Congress” (the Report) needs revision in order to provide a complete and accurate summary of DNSC operations. The Report did not contain important information regarding environmental liabilities, funding commitments, effect of market prices on the stockpile’s net worth, and changes in the DNSC operating budget. This condition existed because DoD guidance and management controls were inadequate to ensure that data in the Report were accurate, consistent, and complete. As a result, congressional oversight committees and senior DoD management could not fully rely on the information presented in the Report for decisionmaking and performance evaluation.

Providing Information to Congress

DoD provides stockpile data to Congress in several ways, including the Report, the “National Defense Stockpile Transaction Fund Financial Statement,” and the Budget Estimates Forum. However, differences in reporting format, methodology, applicable regulations, target audiences, and the decisionmaking issues those audiences use the information to create confusion regarding the overall National Defense Stockpile Program. For example, the inventory value of the stockpile is given in the Report in terms of market value while the financial statements deal with the inventory in terms of acquisition value. Additionally, when looked at separately, none include all the necessary information to show the overall operations and financial status of the stockpile.

Section 11(a) of the Act provides the basic guidance on what is required to be included in the Report. Subsections (1) through (4) deal with acquisitions of strategic materials and research into developing more secure sources of those materials. Subsection (5) requires a statement of the financial status of the National Defense Stockpile Fund and the funding inflows and outflows for the specific fiscal year in question. Subsection (6) requires “such other pertinent information on the administration of this Act as will enable the Congress to evaluate the effectiveness of the program provided for under this Act and to determine the need for additional legislation.”

The Reports for FYs 1993 through 1997 were selected for review and analysis. Facts and data in the Reports were verified with those responsible for them at

DNSC (who originated and compiled the Reports) and with the Office of the Deputy Under Secretary of Defense (Industrial Affairs and Installations), which verified and approved the Reports.

Accuracy of Data

Data in the Reports were inaccurate. Specifically, the Reports contained errors that involved inventory reported value, consignment or loan of inventory, and AMP value.

Arithmetic and Transposition Errors. In all 5 fiscal years reviewed, the "Totals: Strategic and Critical Materials" (in dollars) did not match the inventory values of the individual materials in "Table 5: Stockpile Goals and Inventory Status as of September 30, [1993 through 1997]." The differences ranged from \$90,000 to \$68.2 million and could not be accounted for by DNSC rounding practices. Table 3 compares the stockpile inventory dollar totals in the Reports to the actual dollar totals of the individual stockpiled materials.

Table 3. Depiction of Inventory Errors

	<u>Report Total</u>	<u>Actual Total</u>	<u>Difference</u>
FY 1993	\$5,709,405,000	\$5,710,312,000	\$ 907,000
FY 1994	6,419,277,000	6,487,473,000	68,196,000
FY 1995	6,378,031,000	6,376,588,000	1,443,000
FY 1996	6,072,359,000	6,072,269,000	90,000
FY 1997	5,391,818,000	5,387,198,000	4,620,000

Based on detailed analysis of the preparation of Table 5 in the FY 1997 Report, the basic cause of the differences between the Report and actual totals was that the data input was submitted in an Excel spreadsheet file but was then manually transcribed into a Word document file. That permitted typographical errors and provided no check of the arithmetic.

We suggested that data submitted for the Report remain in Excel spreadsheets, which can be embedded in Word documents, thus eliminating typographical errors caused by manual transcription. DNSC issued a revised Standard Operating Procedure, dated May 13, 1998, that should eliminate the problem in the future.

Consignment or Loan of Inventory. The total value of the stockpile inventory in Table 5 of the FY 1997 Report was inaccurate and understated the total value

Finding B. Reporting of DNSC Operations to Congress

of the stockpile inventory. That resulted from the DNSC customary practice of removing items from inventory when consigned or loaned to other organizations. DNSC loaned platinum for research purposes to Lawrence Livermore National Laboratory and consigned platinum to the U.S. Mint for commemorative coins. Silver was also given on consignment to the U.S. Mint for coinage purposes. Furthermore, DNSC released various quantities of palladium and platinum for upgrades outside DNSC.

For the consignments and loans, the recipients were required to pay only for amounts actually consumed, usually within 30 days of use. By written agreement, DNSC had the right to request the return of any unused amounts at any time. As DNSC released materials through consignments, loans, or upgrades, it removed the items from its inventory by quantity and market value. As a result, items DNSC still held title to were removed from its inventory, which caused an understatement of the stockpile inventory.

Table 4 shows that DNSC treatment of consignments and loans of stockpiled materials caused the total inventory value of the stockpile to be understated by \$68.7 million for FY 1997.

**Table 4. Analysis of Reported and Actual Inventory
for Selected Stockpiled Materials for FY 1997**

	<u>Reported Quantity (Tr Oz)*</u>	<u>Actual Inventory (Tr Oz)</u>	<u>Difference (Tr Oz)</u>	<u>Price as of 9/30/97 (Tr Oz)</u>	<u>Value (price times difference)</u>
Palladium	1,247,282	1,249,485	2,203	\$146.49	\$ 322,718
Platinum	261,513	442,427	80,914	369.38	66,826,013
Silver	39,152,484	39,780,460	627,976	2.44	<u>1,532,261</u>
Total					\$68,680,992

*Troy ounce

DNSC needs to fully report in its inventory the value and quantity of materials it still has title to, regardless of the physical location of the materials.

AMP Value Errors in the Report. The "Total Value of Potential Sales" of the FY 1998 AMP, given as \$598.9 million in Table 3 of the FY 1997 Report, was understated by up to \$116 million. Table 3 in the Report lists the materials and their respective quantities to be sold as part of the FY 1998 AMP. Our analysis of

that table determined 10 of the 59 materials with an AMP had quantities listed that exceeded the inventory on September 30, 1997. Table 3 did not indicate the market prices used to derive the \$598.9 million total. By multiplying the quantities listed in Table 3 of the Report by their respective market prices taken from Table 5 of the Report, we arrived at a total value of potential sales of \$677.2 million, which was \$78.3 million more than the reported figure. Several items in Table 3 could not be priced out using Table 5 because their market prices were not listed (for instance, celestite and kyanite) or because they were listed as groups rather than single materials (such as the manganese ferro group and mica group). Those unpriced items, depending on the sales mix, could add another \$18 million to \$38 million, bringing the total difference to a range between \$96 million and \$116 million. The difference, as previously described, resulted from data being manually transcribed from an Excel spreadsheet into a Word document file.

Consistency of Data

Data in the Reports were inconsistent. The Reports showed inventory and sales data that did not consistently reflect changes in inventory balances. That resulted from reporting policy inconsistencies or simple errors.

Inventory and Sales Data. In all 5 fiscal years reviewed, reporting of sales activity for individual materials was sometimes inconsistent with reporting of inventory changes for those same materials. Stockpiled materials may be sold through sales contracts, used as payment for purchased services (such as upgrades), bartered for quantities of other materials, or transferred to another Government agency. The dollar values of those transactions (except for transfers) are included in Table 1, "National Defense Stockpile Sales, Fiscal Year 19[xx]," of the Report. Table 5 of the Report lists the inventory level of each material as of September 30, 19[xx].

Subtracting the inventory quantity of a material at the end of one fiscal year from the inventory quantity of the same material at the end of the previous fiscal year yields a quantity of that material that should be accounted for in Table 1. Using data from FYs 1993 through 1997, 347 (100 percent) comparisons were made of yearly inventory changes and Table 1 transactions for the appropriate fiscal year.

Table 1 transactions agreed with inventory changes in only 128 of 347 comparisons. The remaining 219 comparisons were filtered to eliminate those comparisons where the disparity was insignificant (insignificant being defined as 10 percent or less). The result was that 85 demonstrated inventory changes that could not be attributed to sales activity or routine inventory adjustments not related to sales.

Finding B. Reporting of DNSC Operations to Congress

Analysis of Data Disparities. Policy and procedural errors contributed to sales and inventory data disparities in the Report, as shown below.

- o Multi-year contracts: using a 3-year contract as an example, sales for the first year were included in Table 1, but the entire 3-year quantity was removed from the inventory shown in Table 5.
- o Delays in posting zero balances to the Master Inventory File (can take several years).
- o Failure to report all materials used to pay for other material upgrades on Table 1 of the applicable fiscal year.
- o Slow posting of new material (due to testing requirements) to the inventory records (has taken up to 2 years).
- o Shipment data not provided to individuals responsible for posting inventory data.
- o Sale and shipment occurred in different fiscal years, with the sale noted in Table 1 for the fiscal year the sale occurred but Table 5 inventory was not changed until shipment.
- o Discrepancy between inventory unit of issue and sale unit of issue.
- o Error in inventory unit of issue.
- o Sales noted in Table 1 sometimes consisted of sales from two different fiscal years.

DNSC needs to address the sales activity and inventory changes in a consistent manner for all stockpiled materials. Inventory changes that occur within a given year should match that particular year's sales and disposal data.

Completeness of Data

Data in the Reports were incomplete. Specifically, the Reports gave incomplete data about the DNSC operating budget, the stockpile value, funding commitments, and environmental liabilities and gave an incomplete description of what an AMP represents.

Operating Budget Data. The DNSC operating budget increased by 39.1 percent for FY 1998, yet there was no explanation for this increase in the Report. The increase in budget authority of approximately \$20 million was almost entirely due to a recognition of the existence of environmental liabilities and the need to start addressing them (with funding set-asides). The purpose of the change was captured in Program Budget Decision No. 430, November 17, 1997. However, that document had an extremely limited distribution, and the audience targeted by the Report would be better served if DNSC included the information in the Report. The DNSC needs to report fully the reasons behind any change (greater than the rate of inflation) in its operating budget in the Report.

Market Effects on Stockpile Value. DNSC failed to adequately address the effect of changes in market prices of stockpiled materials on the value of the stockpile, which would have disclosed that the stockpile inventory value had declined by almost \$158 million in FY 1997. Table 5 of the Report lists the September 30, 1997, inventory quantities and market values of all its materials. Although market prices of individual materials fluctuate over time, the overall value of the stockpile increased for every year of our review except FY 1997. However, even in the years that the overall inventory value increased, the rate of change decreased. In FY 1997, the change became negative by \$158 million. A graph illustrating this trend is in Appendix F. Should this trend continue, it would have implications on future funding commitments currently assessed against the stockpile.

DNSC needs to provide visibility to the effect of market prices on the value of the stockpile. An analysis should be accomplished each year and provided in the Report.

Funding Commitments. DNSC did not provide an organized summary of exactly what funding commitments had been assessed against the stockpile in succeeding fiscal years. The stockpile was used as a vehicle to generate cash, which then was transferred to other Government programs. The programs included funds for the Defense Reutilization and Marketing Service, Defense Working Capital Fund, Foreign Military Sales Program, Service Operation and Maintenance budgets, and the Taxpayer Relief Act. Some, but not all, of this information was scattered throughout the Report. The target audience of the Report would be better served by consolidating this information into one exhibit. All of that information was readily available to DNSC from the Office of the Under Secretary of Defense (Comptroller). The budget analyst in that office who is responsible for DNSC operations provided the information shown in Appendix G. DNSC needs to incorporate this information, with appropriate explanatory notes, into the Report.

Finding B. Reporting of DNSC Operations to Congress

Environmental Liabilities. DNSC had not provided information about costs of environmental liabilities in the Report. Three materials in particular--asbestos (amosite and chrysotile), mercury, and thorium nitrate--had \$116 million in environmental liability costs already identified but not reported. Another four materials have unknown environmental disposal costs. Those materials either have no market, a limited market, or are restricted from sale. DNSC will have to dispose of them at some point. Funds have been budgeted to address the problem, but the funds are insufficient and are budgeted for use over several fiscal years. A more complete explanation of environmental liabilities is presented in Appendix H.

DNSC needs to request the Under Secretary of Defense (Comptroller) to fully fund (via set-asides), as soon as possible, known environmental liability costs. Those liabilities may not be able to be remedied in a single fiscal year. However, the maximum remediation that can be accomplished in a given fiscal year for a particular environmental liability can be calculated and then fully funded. For example, stockpiled mercury, which is restricted from sale, is in flasks that are deteriorating. The cost of reflasking the mercury is estimated at about \$14 million. However, no money was budgeted for reflasking in FY 1998 and only \$1 million was budgeted in FY 1999.

Funds currently exist in the DNSC Transaction Fund to fully fund known DNSC environmental liabilities. Further, environmental liability costs should be included in the Report and updated each year to reflect any changes in on-hand quantities or environmental regulations.

What an AMP Represents. DNSC ascribed dollar values to its AMP that may have led to erroneously high revenue expectations by DoD management and Congress. The AMP was presented for congressional approval by quantity (weight) and approved by Congress based on the quantity (weight) of each material. By ascribing a monetary value, DNSC did not adequately disclose what an AMP represented.

An AMP has two dimensions. The first dimension is a constant: a ceiling. DNSC may sell or dispose of no more than the quantity specified in an AMP for a particular material in a given fiscal year. The second dimension is a variable: material can have an AMP quantity that reflects the amount that could be reasonably expected to sell. In some cases, an AMP quantity is specified for material that has not sold in a long time and is not expected to sell. In some cases, an AMP quantity is specified for how much of a stockpiled material (by weight) must be sold to meet a legislated dollar goal for that particular material, with the quantity usually doubled or more to ensure the target dollar amount could be met.

even if market prices declined. In other cases, AMP quantities are scheduled for facilitating the zeroing out of a material from the stockpile. That authorization must be high enough to cover the residual amount plus inventory adjustments and the possibility of any canceled sales contracts. Other materials that are not authorized for sale because of regulatory problems have AMP quantities in case the regulatory authority is obtained to sell the material. A comparison of actual sales to value of potential sales on an AMP for all stockpiled materials for that fiscal year ranged from 64.9 percent to 100.4 percent. Table 5 shows the results of our analysis.

Table 5. Dollar Comparison of Stockpile Sales to the AMP

	<u>Actual Stockpile Sales Revenue</u>	<u>AMP Potential Sales</u>	Potential Realized (percent)
FY 1993	\$322,433,508	\$496,900,000	64.9
FY 1994	49,322,874	508,200,000	88.4
FY 1995	427,560,319	425,800,000	100.4
FY 1996	390,815,480	538,900,000	72.5
FY 1997	513,180,968	601,900,000	85.3

When the overall AMP was broken down into an analysis of the individual materials over time, the comparisons of actual sales to potential sales on an AMP were more varied. For example, in FY 1997, the percentage of actual sales to potential sales for individual materials ranged from 0 percent to 105.9 percent.

Furthermore, interviews with DNSC personnel demonstrated the unanimous opinion that the AMP was not a goal or target, but a ceiling amount for sales. In the Reports for FY 1993 and FY 1994, DNSC provided a dollar value for its revised AMPs in close proximity to its sales results for the year. In FY 1995 and succeeding years, DNSC omitted the AMP dollar value because it did not want sales and AMP numbers to be compared as if they meant the same thing. However, DNSC continued to include AMP dollar values elsewhere in the Report.

DoD and DNSC need to report accurately, consistently, and clearly what an AMP represents. Further, because of market price fluctuations, the varying purposes of AMPs for individual materials and the time lag between AMP approval and actual sales, dollar values of stockpiled materials can change significantly and should not, therefore, be included in AMPs.

Guidance and Oversight

The Deputy Under Secretary of Defense (Industrial Affairs and Installations) and DLA had not provided sufficient guidance and oversight to DNSC in the preparation of the Reports to ensure a complete and accurate description of both DNSC operations and the factors that influence it. Specific guidance for each table in the Report did not exist. The Report is an evolutionary document that was developed over the years on an "ad-hoc" basis. The Report consists of minimally basic data about the stockpile and any other items of interest that are specifically requested by Congress or senior DoD management. The stockpile value changes from day to day, as does the authority to dispose of it. By providing very limited and sometimes inaccurate information, congressional oversight committees and senior DoD managers cannot fully rely on information in the Report for decisionmaking and performance evaluation.

Reports provided to oversight authorities did not provide consistent and comparable information. DoD annually provides financial and operational data about the stockpile to Congress in the Report. DoD provides further financial data in the annual "National Defense Stockpile Transaction Fund Financial Statement" (the Financial Statement). The data provided in those two documents differ in applicable regulations, format, methodology, and level of detail. Also, the financial data presented in both reports do not always agree. For instance, the FY 1997 Report identified sales of \$513 million, while the FY 1997 Financial Statement identified sales (revenues) of \$531 million. The Report and the Financial Statement are prepared and submitted annually to Congress by January 15 and June 30, respectively. Considering the need for each and their differences, we concluded that both documents should be prepared using the same sources of financial data and submitted at the same time to present a clear and concise picture of stockpile operations.

Recommendations and Management Comments

B.1. We recommend that the Deputy Under Secretary of Defense (Industrial Affairs and Installations) and the Director, Defense Logistics Agency, establish guidance on the preparation of the "Strategic and Critical Materials Report to Congress" (the Report). As a minimum, the guidance should address:

- a. Reporting the full inventory of the National Defense Stockpile (the stockpile) quantity and value, including all materials to which it holds title, regardless of physical location.**

- b. Presenting the sales activity and inventory changes in a consistent manner for all materials.**
- c. Reporting reasons behind any change (greater than the rate of inflation) in the Defense National Stockpile Center operating budget.**
- d. Reporting information concerning the effect of market prices on the value of the stockpile.**
- e. Reporting information regarding funding commitments assessed against revenues received from the sale of stockpiled materials, including appropriate explanatory notes.**
- f. Reporting the estimated environmental liability costs.**
- g. Reporting accurately, consistently, and clearly what the Annual Materials Plan represents, excluding dollar values.**
- h. Using the same sources of financial data and date for the Report as the "National Defense Stockpile Transaction Fund Financial Statement."**

Deputy Under Secretary of Defense (Industrial Affairs and Installations) Comments. The Acting Deputy Under Secretary of Defense (Industrial Affairs and Installations) concurred, stating that he requested DLA to develop specific guidance for the Report in the eight areas recommended.

Defense Logistics Agency Comments. DLA concurred, stating DNSC will work with the Deputy Under Secretary of Defense (Industrial Affairs and Installations) to develop guidance on the preparation of the Report that incorporates applicable recommendations from this evaluation. Guidance will be completed by January 29, 1999.

B.2. We recommend that the Administrator, Defense National Stockpile Center, request the Under Secretary of Defense (Comptroller) to fully fund (via set-asides) known environmental liability costs.

Defense Logistics Agency Comments. DLA concurred, stating DNSC has requested full funding of known environmental liability costs in the DLA FYs 2000 and 2001 Budget Estimate Submission.

**This Page Intentionally
Left Blank**

Part II - Additional Information

Appendix A. Evaluation Process

Scope

Work Performed. We evaluated the effectiveness of the sales contracting and disposal of stockpiled materials, and the reliability of information given in the Report for FYs 1993 through 1997. We reviewed the DNSC Sales Handbook, the Strategic Master Plan, and Annual Sales Plans. We also reviewed the status of implementation of Office of Management and Budget (OMB) Circular No. A-76 (Revised), "Performance of Commercial Activities," August 4, 1983, as it pertains to DNSC. Further, we reviewed DoD policies and procedures for reducing the stockpile inventory and the adequacy of management controls over the contracting and sale of stockpiled materials. We obtained information on the disposition of revenue collections for FYs 1998 through 2003.

Limitations to Scope. We did not validate the accuracy of financial data that supported the information presented in the Report because verification of that data was not necessary to meet evaluation objectives.

DoD-Wide Corporate Level Goals. In response to the Government Performance and Results Act, DoD has established 6 DoD-wide corporate level performance objectives and 14 goals for meeting these objectives. This report pertains to achievement of the following objective and goal:

Acquisition Functional Area. Objective: Internal reinvention.
Goal: Dispose of \$2.2 billion in excess stockpile inventory and \$3 billion in unneeded Government property while reducing supply inventory by \$12 billion.
(ACQ-3.3)

High Risk Area. The General Accounting Office has identified several high risk areas in DoD. This report provides coverage of the "Infrastructure Reduction" high risk area.

Methodology

The evaluation involved on-site interviews at DNSC, Fort Belvoir, Virginia; the Department of Commerce; the Office of the Deputy Under Secretary of Defense (Industrial Affairs and Installations); and the Under Secretary of Defense (Comptroller). We also conducted an analysis of the data contained in the Reports for FYs 1993 through 1997. Specifically, for our evaluation, we:

- o stratified the 88 materials comprising the stockpile into 4 sectors based on sales activity to determine the effectiveness of sales contracting and disposal strategies;
- o examined the sales restrictions and environmental liabilities imposed by regulatory agencies on stockpiled materials and the DNSC plans to dispose of those materials;
- o examined the sales and disposal plans for lesser demand materials and the causes of their market inactivity;
- o determined the financial and operational impact of the top 15 high demand materials on plans for the eventual dissolution of the stockpile;
- o analyzed the accuracy, completeness, and consistency of data presented in the Reports for FYs 1993 through 1997;
- o reviewed the implementation status of OMB Circular No. A-76; and
- o compared information and submissions of financial data and Reports to Congress.

Use of Computer-Processed Data. We did not use computer-processed data in performing this evaluation.

Evaluation Type, Dates, and Standards. This program evaluation was performed from October 1997 through May 1998 in accordance with standards issued and implemented by the Inspector General, DoD.

Contacts During the Evaluation. We visited or contacted individuals and organizations within the DoD. Further details are available on request.

Management Control Program

DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996, requires DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of those controls.

Scope of Review of Management Control Program. We reviewed the adequacy of the management controls over the sales contracting and disposal of

Appendix A. Evaluation Process

stockpiled materials to ensure effective reduction of the stockpile inventory and reporting to senior decisionmakers. Because we did not identify a material weakness, we did not assess management's self-evaluation.

Adequacy of Management Controls. The DNSC management controls for sales contracting were adequate. The Director, Stockpile Contracts, had implemented procedures to correct weaknesses identified by DLA and the Defense Criminal Investigative Service in February 1996. See Appendix C for a detailed discussion of our review of the sales contracting operations.

Appendix B. Summary of Prior Coverage

During the past 5 years, the Inspector General, DoD, issued two reports and DLA issued one report that pertain to this evaluation.

Inspector General, DoD

Inspector General, DoD, Report No. 98-166, "Internal Controls and Compliance With Laws and Regulations for the FY 1997 National Defense Stockpile Transaction Fund Financial Statements," June 25, 1998. The Chief Financial Officers Act of 1990, as amended by the Federal Financial Management Act of 1994, requires an annual audit of the National Defense Stockpile Transaction Revolving Fund. The audit was to render an opinion on whether financial statements were presented fairly and according to OMB policy; whether internal controls were adequate; and whether management complied with applicable laws and regulations as they relate to financial statements. A determination about FY 1997 National Defense Stockpile Transaction Fund Financial Statements could not be made because inventory value could not be verified and accounts receivable could not be confirmed. Internal controls were generally effective in accounting for and managing resources, ensuring compliance with laws and regulations, and providing reasonable assurance that the financial statements were free of material misstatements. None of the accounts affected by internal control weaknesses resulted in a material misstatement on the financial statements.

The report states that although management generally complied with selected provisions of applicable laws and regulations on the accuracy of the financial statements, DSNF did not comply with Federal Financial Accounting Standard No. 3 for stockpile inventory that had declined in value. In addition, DSNF inappropriately retained funds received for the sale of certain stockpiled materials and failed to recognize pension costs as a liability on the financial statements. The report recommended that the Director, Defense Finance and Accounting Service Columbus Center, assume responsibility for collection of all accounts receivable and that the Administrator, DSNF, and the Director, Defense Finance and Accounting Service Columbus Center, promptly adjust accounts receivable on closed contracts and promptly post collections to accounts receivable. Further, the report recommended that the Administrator, DSNF, request written statements from the U.S. Mint on the total amount of silver it had from the stockpile; recognize inventory losses; and prepare the FY 1998 financial statements in compliance with applicable laws and regulations. The report also recommended

Appendix B. Summary of Prior Coverage

that the Under Secretary of Defense (Comptroller) promptly transfer funds from the sale of certain stockpiled materials to the general fund of the U.S. Treasury.

Defense Criminal Investigative Service Investigation: Management Control Deficiency Report (Control No. 44), July 29, 1996. The Defense Criminal Investigative Service issued a management control deficiency report based on an investigation involving the sale of metallurgical grade fluorspar and other materials. Although the investigation disclosed no evidence of criminal activity, the investigation identified the lack of training of contract specialists and the absence of written regulations governing the sale of stockpiled materials as issues that the Management Control Program needed to address.

Defense Logistics Agency

DLA Material Management and Procurement Management Review, February 5-16, 1996. DLA officials found deficiencies in DNSC procedures for preparing sales strategy plans, pricing objectives memorandums, and sales solicitations. DLA recommended that the DNSC update and develop written policy and procedures for processing procurements and sales. DNSC complied with the Procurement Management Review requirements by implementing sales standard operating procedures, conducting daily and quarterly reviews, and conducting training sessions to alleviate deficiencies. It also instituted a Sales Competition Advocate and a Contracting Officer Review Board and increased the number of supervisory reviews.

Appendix C. Other Matters of Interest

This Appendix includes the following topics related to DNSC:

- o A-76 review and
- o DNSC sales contracting.

A-76 Review. We reviewed the implementation status of OMB Circular No. A-76 (Revised), as it pertains to DNSC. DoD Directive 4100.15, "Commercial Activities Program," March 10, 1989, implements OMB Circular No. A-76. In a January 5, 1998, memorandum, the Deputy Secretary of Defense, through Defense Reform Initiative Directive No. 18, formally tasked the Director, DLA, to initiate a review of all functions involved in stockpile sales and to report on the feasibility of competing those functions in the commercial arena to the Under Secretary of Defense (Acquisition and Technology) by February 1, 1998.

DLA completed the directed feasibility study prior to February 1, 1998, and forwarded its findings to the Under Secretary of Defense (Acquisition and Technology) for review. The DLA feasibility study concluded that DNSC was not a candidate for privatization. The Deputy Under Secretary of Defense (Industrial Affairs and Installations) disagreed and returned to DLA the feasibility study, as written, because it inappropriately combined the concepts and characterizations of privatization with those of competition defined in OMB Circular No. A-76.

DLA performed a second feasibility study to determine if an A-76 study would be required. DLA presented its case for not performing an A-76 study because:

- o DNSC sales are closely controlled by congressional legislation for reasons of national security and commercial market protection and
- o within the next 10 years, if everything goes as planned with the DNSC complete disposal of excess material, it will no longer be selling material, alleviating the need to compete or privatize.

On April 24, 1998, DLA resubmitted the feasibility study of competing functions involved in stockpile sales. DLA officials stated that if the Office of the Under Secretary of Defense determines that a complete A-76 study should be accomplished, then DLA would comply and have DNSC perform the study. On November 4, 1998, the Under Secretary of Defense for Acquisition and

Appendix C. Other Matters of Interest

Technology approved the DNSC/DLA study and recommendation not to compete the functions of the stockpile, thereby eliminating the requirement for an A-76 study.

DNSC Sales Contracting. We reviewed DNSC sales contracting because of deficiencies found by a February 1996 Procurement Management Review. The DLA Material Management Directorate conducted that review of DNSC sales contracting and supporting acquisitions. Sales contracting deficiencies included insufficient sales contracting policies and procedures.

On July 29, 1996, the Defense Criminal Investigative Service issued a Management Control Deficiency Report that identified the lack of training of contract specialists and the absence of written regulations governing the sale of stockpiled materials as issues that the Management Control Program needed to address. The Director, Stockpile Contracts, included those deficiencies in the DNSC FY 1997 Risk Assessment and Management Control Review and subsequently implemented policies and procedures that corrected the deficiencies. DNSC also developed standard operating procedures and conducted random quarterly reviews of contract files.

In March 1997, the Director, Stockpile Contracts, reviewed a small sample of contract files to determine if procedures were adequate and files were maintained properly. DNSC found that only 25 percent of the sample files were accurate and complete. DNSC wrote additional standard operating procedures, conducted daily reviews, and provided individual training as needed to ensure the accuracy and completeness of contract files.

The Stockpile Contracts Directorate developed three standard operating procedures to include in the Handbook: Sales Strategic Plans (March 1997), Recommendation for Award (July 1997), and Pricing Objectives Memorandum (August 1997). Additionally, DNSC developed a sales contracting checklist for contract files and a template for standard sales solicitation provisions and contract clauses. In January 1998, the Directorate conducted another review and concluded that most contract specialists were complying with standard operating procedures; those with special problems were given one-on-one instruction.

To validate that the material weakness had been corrected, we reviewed 29 percent (81 of 284) of the files for sales contracts awarded from September 1997 through March 1998. We found that 83 percent (67 of 81) of the sales contracting files reviewed contained information required by the DNSC standard procedures. Contract specialists were either staffing or developing the

Appendix C. Other Matters of Interest

documents that were missing. We also did an on-the-spot review of one pre-award file per contract specialist. Generally, contract specialists were complying with required procedures. We interviewed DNSC contracting officers and specialists; the senior procurement analyst; and the Director, Stockpile Contracts. Contract specialists were satisfied with the level of policy guidance and training in sales contracting.

To continue improvements in the sales contracting area, the Director, Stockpile Contracts, agreed with our suggestions to delegate the review of standard contractual documents to team leaders, consolidate interim sales policy, consider developing an in-house sales contracting training forum, and continue to correct the portion of deficiencies identified during the Procurement Management Review.

Appendix D. Factors Influencing Stockpile Operations

The Act, under which DNSC operates its sales program, mandates that, to the maximum extent feasible, sales be competitive, avoid undue market disruption, and protect against avoidable loss to the taxpayer. That requires review and analysis of all the available data relative to each material. If DNSC accepts prices that are below fair market level and obtains lower revenues than could be realized, DNSC might be accused of undue market disruption. Accepting prices that are too low relative to the market could also drive down prices offered on the same material in the future. In making a decision on what is a fair and reasonable price to accept, DNSC attempts to balance all factors.

Congressional influence, market conditions, and regulatory constraints restricted, delayed, or prevented sales of stockpiled materials with approved AMPs.

Congressional Influence. Congress had primary control over the sale of stockpiled materials because it stipulated which materials could be sold, how much, and sometimes to whom. DoD requests authority to sell stockpiled materials from Congress. Congress either approves or disapproves the request. Once authority is granted, the rate at which the material is sold or depleted must also be approved by Congress. The process is known as the AMP.

In addition to the AMP, Congress passes legislation for disposal authority of materials with specific quantities for disposal and with established monetary targets in order to fund other programs. For example, Public Law 104-201, section 3303, "Disposal of Certain Materials in National Defense Stockpile," was written to support the Foreign Military Sales Program. It authorizes DNSC to dispose of 11 materials at certain levels (for example, 62,881 short tons of aluminum; 26,000,000 pounds of cobalt) and requires that the monies received through those DNSC sales be deposited into earmarked Treasury accounts. During FY 1997, DNSC sales of those materials provided \$81 million to supplement the Foreign Military Sales Program. Furthermore, for FY 1998, DNSC recommended to the Secretary of Defense that eight new materials be authorized for disposal. However, Congress authorized the sale of only three of the eight materials.

Market Influences. Market conditions influence the sale of stockpiled materials. The overarching statutory mandate to not cause undue market disruption requires the Administrator, DNSC, as well as the MIC, to pay close attention to industry

concerns, particularly for those materials where information on markets was incomplete and where there was a substantial degree of market uncertainty or industry interest in the sales. Additionally, the Act requires the MIC to examine background information and data for each material and its disposal quantities, and advise the Administrator.

To determine the disposal levels for the AMP, the MIC, which was legislatively established, reviews each material. To prepare the AMP, DNSC and the MIC pay close attention to industry concerns for those materials where information on markets was incomplete, where there was a substantial degree of market uncertainty, or where industry interest in the sale was substantial. The MIC also considers price trends, world stock levels, changing trade patterns, public comments, and DNSC efforts to protect the U.S. Government from avoidable loss.

A major factor in the sales process is establishing the price at which DNSC can sell stockpiled materials. DNSC follows various world material price indexes, such as the London Metals Exchange, to determine a fair sale price. Material was generally sold at a discounted price because it was sold in "as is--where is" condition, without any guarantee about the quality of the material and no accommodations regarding transportation, financing, or delivery dates. Another factor that greatly influences sales of stockpiled materials is the worldwide supply and demand for a particular material. When world markets are full or in a surplus status, the expected DNSC price is lower than if the world market is in a shortage condition. DNSC has no control over this factor.

Environmental Influences. The sales of stockpiled materials are influenced by environmental constraints. The Environmental Protection Agency (EPA) regulates stockpiled items such as asbestos and mercury. Both are environmentally sensitive and governed by EPA disposal rules. For instance, DNSC has suspended mercury sales since 1994 at the request of EPA. The Nuclear Regulatory Commission regulates stockpiled materials such as radioactive tantalum and thorium nitrate. Some materials are regulated by both the EPA and the Nuclear Regulatory Commission. The Drug Enforcement Agency regulates stockpiled items such as iodine, morphine, and quinine. Those regulatory constraints affected the ability of DNSC to maximize sales of stockpiled materials.

Appendix E. National Defense Stockpile Composition

For purposes of this report, the stockpile consists of four sectors, as shown in the table below. A short discussion of those sectors follows.

Stockpile Composition by Sector				
<u>Sector</u>	<u>Material Composition</u>	<u>Number of Materials</u>	<u>Value (millions)</u>	<u>Percent of Stockpile Value</u>
I	Top 15 Materials	15	\$3,300	62
II	No Disposal Authority for Materials	17	1,300	25
III	Strategic and Critical Materials	6	44	1
IV	Restricted and Limited Markets	50	654	12
Total		88	\$5,298	100

Sector I: Top 15 Materials. The top 15 high demand materials (valued at \$3.3 billion) account for 62 percent of all future revenues expected to be generated by DNSC. The materials have a strong demand in the private sector and bring fair prices when sold. Examples of those materials are cobalt, diamonds, germanium, lead, tin, and zinc.

Sector II: No Disposal Authority for Materials. Sector II contains 17 materials, valued at \$1.3 billion, that are excess to the needs of DoD. They account for 25 percent of the stockpile value. Some examples of those materials are chromium, columbium ores, platinum, and tungsten. Congress has not granted authority for DNSC to begin sales and disposal of those materials because it has not yet officially accepted the DoD position that they are excess. Until disposal authority is granted by Congress, they must be stocked and maintained by DNSC.

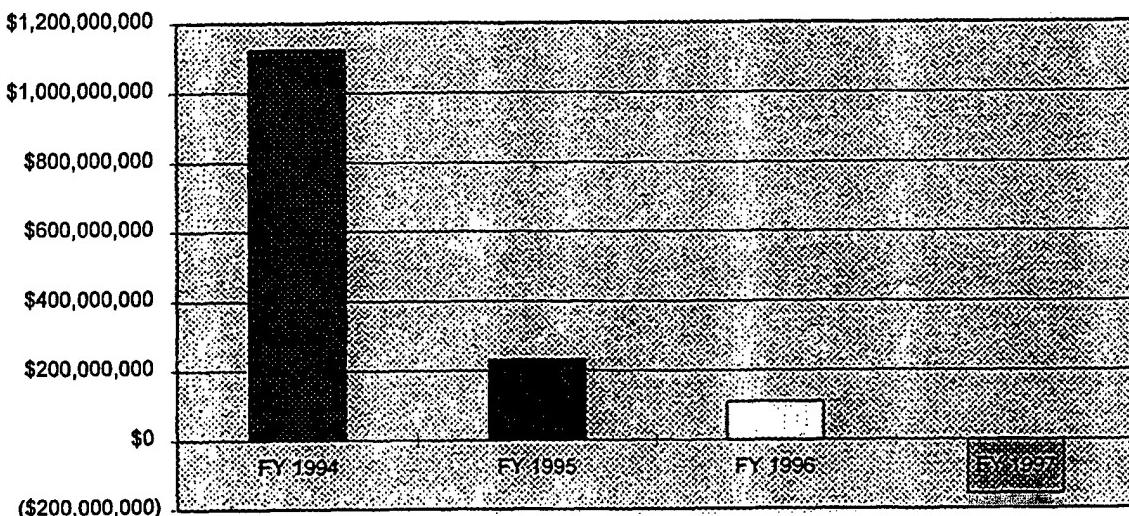
Sector III: Strategic and Critical Materials. The six materials still requiring stockpiling (bauxite, beryllium, iridium, mica, palladium, and quartz) have a combined value of \$44 million and represent less than 1 percent of the value of stockpiled materials.

Sector IV: Restricted and Limited Market Materials. Composed of 50 materials, valued at \$654 million, Sector IV accounts for 12 percent of all future revenues expected to be generated by DNSC. However, the sector contains 11 materials that require DNSC adherence to restrictive sales and disposal guidance, including materials that are environmentally sensitive and require special handling by DNSC.

- o Some materials, including columbium concentrates, tantalum minerals, and thorium nitrate, are radioactive and require a Nuclear Regulatory Commission license to handle.
- o Materials such as asbestos and mercury are politically as well as environmentally sensitive and are governed by EPA disposal rules. At the request of the EPA, mercury sales have been suspended since 1994.
- o Analgesic sales (morphine), iodine, and quinine are governed by the Controlled Substance Act, which requires Drug Enforcement Agency approval for sale.
- o The other 39 materials in this sector have a limited market (and in some cases no market) for their sale. Examples of these materials are cadmium, graphite, quinidine, talc, and tannin.

Appendix F. Market Effects on Stockpile Value

CHANGES IN STOCKPILE VALUE DUE TO CHANGES IN MARKET PRICES



For FYs 1994 through 1996, changes in market prices of stockpiled materials were an additive to the value of the stockpile. However, the market price rate of change decreased each year. In FY 1997, following the 4-year trend, market price changes actually caused the stockpile to lose almost \$158 million in value. Should that trend continue, it will have serious implications regarding the ability of stockpile sales to meet funding commitments levied by Congress and DoD.

Appendix G. National Defense Stockpile--Cash Projection

National Defense Stockpile—Cash Projection (in millions of dollars)							
	<u>FY 1998</u>	<u>FY 1999</u>	<u>FY 2000</u>	<u>FY 2001</u>	<u>FY 2002</u>	<u>FY 2003</u>	<u>Total</u>
Beginning balance	\$450	\$518	\$140	\$333	\$511	\$606	
Collections	373	314	385	370	287	235	\$1,964
Uses							
Operation of the NDS ¹	-79	-87	-87	-87	-87	-87	-514
Receipt Account of the Treasury (DRMS) ²		-42	-42	-42	-42	-42	-210
Receipt Account of the Treasury (FMS) ³	-59	-59	-59	-59	-59	-59	-354
Receipt Account of the Treasury (Taxpayer)	-17	-4	-4	-4	-4	-4	-37
Transfer to DWCF ⁴			-350				-350
Transfer to Service O&M ⁵	-150	-150					-300
Ending balance	\$518	\$140	\$333	\$511	\$606	\$649	

¹ National Defense Stockpile

² Defense Reutilization and Marketing Service

³ Foreign Military Sales

⁴ Defense Working Capital Fund

⁵ Operation and Maintenance

This is a projection from the Office of the Under Secretary of Defense (Comptroller) of the DNSC estimated revenue stream and planned funding commitments. There are \$1.251 billion in commitments and planned assessments outstanding on stockpile revenues through FY 2003. That number increases to \$1.765 billion when DNSC operations, which are also funded out of stockpile revenues, are taken into account. Although commitments and planned assessments can be quantified in definitive terms, stockpile revenue projections for outyears are, at best, an educated guess dependent on many factors beyond the control of DNSC. The cash projection shows commitments to the Defense Reutilization Marketing Service, Foreign Military Sales Program, Taxpayer Relief Act, Defense Working Capital Fund, and Service Operation and Maintenance budgets.

Appendix H. Environmental Liabilities

FY 1997 Liabilities

Material	Restriction	Disposal Cost (in dollars)	Notes
Asbestos, Amosite	EPA	Unknown	1
Asbestos, Chrysotile	EPA	\$64,000,000	1
Columbium, Carbide Powder	NRC*	Unknown	2
Columbium, Concentrates	NRC	Unknown	2
Mercury	EPA	14,000,000	3
Tantalum, Minerals	NRC	Unknown	2
Thorium Nitrate	NRC	<u>38,000,000</u>	4
Total		\$116,000,000	

*Nuclear Regulatory Commission

Key Points Shown by Liabilities Table:

- o Note 1. There is a \$64 million liability for the safe disposal of asbestos. The material is hazardous under EPA standards and must be disposed of safely and properly.
- o Note 2. Although a sales market exists for columbium powder and concentrates and tantalum minerals, the purchaser must hold a valid license to handle low-level radioactive materials. Disposal costs are unknown.
- o Note 3. Although a sales market exists for mercury, DNSC has suspended the sale of mercury since 1994 at the request of the EPA and after completing an Environmental Impact Study. The flasks in which the mercury is stored are nearly 50 years old and responsible DNSC management requires refloating at a cost of \$14 million.
- o Note 4. There is a \$38 million liability for the safe disposal of thorium nitrate. It is a low-level radioactive material, and no sales market exists.

Appendix I. Report Distribution

Office of the Secretary of Defense

Under Secretary of Defense for Acquisition and Technology
Deputy Under Secretary of Defense (Environmental Security)
Deputy Under Secretary of Defense (Industrial Affairs and Installations)
Deputy Under Secretary of Defense (Logistics)
Director, Defense Logistics Studies Information Exchange
Under Secretary of Defense (Comptroller)
Deputy Chief Financial Officer
Deputy Comptroller (Program/Budget)
Under Secretary of Defense (Personnel and Readiness)
Under Secretary of Defense for Policy
Assistant Secretary of Defense (Public Affairs)

Department of the Army

Auditor General, Department of the Army

Department of the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller)
Auditor General, Department of the Navy

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller)
Auditor General, Department of the Air Force

Other Defense Organizations

Director, Defense Contract Audit Agency
Director, Defense Logistics Agency
Commander, Defense Reutilization and Marketing Office
Administrator, Defense National Stockpile Center
Director, National Security Agency
Inspector General, National Security Agency
Inspector General, Defense Intelligence Agency

Appendix I. Report Distribution

Non-Defense Federal Organizations and Individuals

Office of Management and Budget
General Accounting Office
 National Security and International Affairs Division
 Technical Information Center

Chairman and ranking minority member of each of the following congressional committees and subcommittees:

Senate Committee on Appropriations
Senate Subcommittee on Defense, Committee on Appropriations
Senate Committee on Armed Services
Senate Committee on Governmental Affairs
House Committee on Appropriations
House Subcommittee on National Security, Committee on Appropriations
House Committee on Government Reform and Oversight
House Subcommittee on Government Management, Information, and Technology,
 Committee on Government Reform and Oversight
House Subcommittee on National Security, International Affairs, and Criminal Justice,
 Committee on Government Reform and Oversight
House Committee on National Security

Part III - Management Comments

Deputy Under Secretary of Defense (Industrial Affairs and Installations) Comments



OFFICE OF THE UNDER SECRETARY OF DEFENSE

3000 DEFENSE PENTAGON
WASHINGTON DC 20301-3000



November 12, 1998

MEMORANDUM FOR INSPECTOR GENERAL, DEPARTMENT OF DEFENSE
ATTN: DIRECTOR, READINESS AND LOGISTICS SUPPORT
DIRECTORATE

SUBJECT: Evaluation Report on Strategic and Critical Materials in the Defense National Stockpile (Project No. 8LN-0001)

This memorandum responds to your request for comment on Finding B and the related recommendation in your draft evaluation report *Strategic and Critical Materials in the Defense National Stockpile*. First, I am pleased to see that the evaluation's major finding is that the overall management of the disposition of Stockpile materials by the Defense Logistics Agency (DLA) is effective, despite the need for more comprehensive sales and disposal plans for Stockpiled materials with restricted or limited markets. Regarding Finding B on needed revisions in the content of the *Strategic and Critical Materials Annual Report to Congress*, I agree with your findings and the related recommendation concerning substantive changes in the report.

Since this recommendation is addressed to me as well as the Director, Defense Logistics Agency, I have sent a memorandum to the Director, DLA (see attachment) requesting that he develop specific guidance for the *Strategic and Critical Materials Annual Report* in the areas that you recommended. If you have any questions regarding this matter, please call my Director of Financial and Economic Analysis, Mr. Victor Ciardello, who can be reached at (703) 588-0176.

Steven C. Grundman
Acting Deputy Under Secretary
(Industrial Affairs and Installations)

Attachment



Deputy Under Secretary of Defense (Industrial Affairs and Installations) Comments



OFFICE OF THE UNDER SECRETARY OF DEFENSE

3000 DEFENSE PENTAGON
WASHINGTON DC 20301-3000



November 12, 1998

MEMORANDUM FOR DIRECTOR, DEFENSE LOGISTICS AGENCY

SUBJECT: Strategic and Critical Materials Annual Report to the Congress

This memorandum concerns a recommendation in the Department of Defense Inspector General's draft evaluation report entitled *Strategic and Critical Materials in the Defense National Stockpile* (No. 8LH-0001) which is addressed jointly to you and the Deputy Under Secretary of Defense (Industrial Affairs & Installations). However, first let me say that I am pleased to see that the audit's major finding is that the overall management of the disposition of Stockpile materials by the Defense Logistics Agency (DLA) is effective. The recommendation in question calls for the development of guidance relating to the content in the *Strategic and Critical Materials Annual Report to the Congress* (see Attachment). I agree with this recommendation and the finding on which it is based. In order to conform to the recommendation, I request that you develop and issue to DLA's Administrator of the Defense National Stockpile Center specific guidance relating to the following eight areas addressed by the Inspector General:

- a. Reporting the full inventory of the National Defense Stockpile quantity and value, including all materials to which it holds title, regardless of physical location.
- b. Presenting the sales activity and inventory changes in a consistent manner for all materials.
- c. Reporting reasons behind any changes (greater than the rate of inflation) in the Defense National Stockpile operating budget.
- d. Reporting information concerning the effect of market prices on the value of the stockpile.
- e. Reporting information regarding funding commitments assessed against revenues received from the sale of stockpiled materials, including appropriate explanatory notes.
- f. Reporting the estimated environmental liability costs.
- g. Reporting accurately, consistently, and clearly what the Annual Material Plan represents, excluding dollar values.
- h. Using the same sources of financial data and date for the Report as is used in the "National Defense Stockpile Transaction Fund Financial Statement."

I thank you for your support in meeting the Inspector General's recommendation.

Steven C. Grundman
Acting Deputy Under Secretary
(Industrial Affairs and Installations)

Attachment



Defense Logistics Agency Comments



IN REPLY
REFER TO

DEFENSE LOGISTICS AGENCY
HEADQUARTERS
8725 JOHN J. KINGMAN ROAD, SUITE 2533
FT. BELVOIR, VIRGINIA 22060-6221

DDAI

7 October 1998

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL FOR AUDITING,
DEPARTMENT OF DEFENSE

SUBJECT: Evaluation Report on Strategic and Critical Materials in the Defense National Stockpile, 8LH-0001

Enclosed are DLA comments in response to your request of 13 August 1998. If you have any questions, please notify Sharon Entsminger, 767-6267.

Encl

Jeffrey P. Raines
JEFFREY GOLDSTEIN
Chief (Acting), Internal Review

cc:
DNSC-DI
DLSC-BO

Federal Recycling Program Printed on Recycled Paper

Defense Logistics Agency Comments

SUBJECT: Strategic and Critical Materials in the Defense National Stockpile, 8LH-0001

FINDING A: Sales and Disposal Stockpiled Materials with Restricted or limited Markets

DLA COMMENTS: Concur. DNSC agrees with the intent of the finding. However, we feel additional clarification is necessary.

"Overall Management of Stockpiled Materials". Although it was true that based solely on the market value in March 1997 DNSC could have achieved the NPR goal with the sale of the commodities that make up the high demand items. However, the list of the top 15 materials would change over time due to the depletion of salable materials and increased sales of other commodities. The estimate of the value of the DNSC inventory has dropped from \$5.5 billion (1997) to \$4.4 billion in August 1998. Under these conditions the sale of the high demand items only will no longer achieve the NPR goal.

The \$2.2 billion was an Administration goal and was based on the assumption that the global economic conditions would remain as stable as when the target was developed. Global economic conditions for commodities have slid to the point that they have reached a 10 to 20 year low in prices. Despite this, the FY 1997 and FY 1998 combined sales were about \$ 975 million.

"Specifically, DNSC commodity sales teams did not maximize sales for 35 of 50 material with restricted or limited markets and approved AMPs."

One should not necessarily draw the conclusion that, because DNSC has 15 high revenue commodities, they "sell themselves." One reason many of them are in that category is because of the attention paid to them by the DNSC managers and staff. Cobalt, one of the "top 15" cited in the Evaluation Report, is a good example. That particular commodity has consumed an inordinate proportion of staff time, to include DNSC's successful defense of its procedures in two lawsuits filed in FY 97. Zinc, another example mentioned in the report, has in recent years also consumed high amounts of staff effort as the sales program came under fierce criticism from the producers' industry association and other lobbyists, leading to two separate General Accounting Office (GAO) investigations (both of which supported the DNSC processes).

This is not to say that Finding A is not valid. It is. However, it is a situation requiring management judgment involving the identification of high potential commodity targets and the application of a workforce limited in size. It is a long-term process and will remain so in this era of workforce downsizing. However, there is always room for improvement. Recent gains have been made in graphite, mica, and manganese ore, for example. Other opportunities remain. Increased outsourcing may be the best answer at this point.

Defense Logistics Agency Comments

"...DNSC had not developed comprehensive disposal plans, to include sales and other methods, for stockpiled materials."

It is true that "comprehensive disposal plans" have not been developed for most of the stockpile materials. However, this is not to say that methods other than sale, such as landfill, incinerations, and others, are not part of the DNSC plan.

In August of 1997, the in-coming DLA Director was briefed on the DNSC 10-year strategic plan, which addressed 87 separate commodities. Of these, 19 were and remain in a category labeled "sell or dispose within a 5-year period."

Disposal plans for most of the 19 have not been completed because the initial effort remains focused on maximizing sales as discussed above. However, where a commodity can definitively be declared non-salable, disposal has already begun. This is the case for most of the asbestos inventory. To date, DNSC has disposed of about 5.5 million pounds and has projects in progress to dispose of another 10 million pounds.

There is no fixed formula for determining whether a market no longer exists for a particular commodity; however, 5 years was considered a reasonable length of time to make that determination in the DNSC Strategic Plan. We are now beginning year 2 of that 5 year period. Emphasis should remain on sales--identifying and expanding potential markets--for the next several years. Definitive disposal plans will be in place for those commodities remaining at the end of the 5 year period. In the judgment of DNSC officials, significant disposals sooner than that, while reducing storage costs, would likely result in even greater losses of potential revenue. The need for supporting cost benefit analyses as noted in the Evaluation, however, is a point well taken. Again, in this era of downsizing, outsourcing may be the answer.

RECOMMENDATION A: We recommend that the Director, Defense Logistics Agency, direct the Administrator, Defense National Stockpile Center, to establish requirements to set annual goals to achieve a higher volume of sales for stockpiled materials with restricted or limited markets and approved Annual Materials Plans and to develop comprehensive disposal plans. At a minimum, the disposal plans should include:

1. An aggressive sales strategy with annual goals to achieve a higher volume of sales for stockpiled materials with restricted or limited markets and approved Annual Materials Plans.
2. A cost benefit analysis, periodic trend analysis, and annual decision points, to determine if disposal by other than sales was desirable.

Defense Logistics Agency Comments

DLA COMMENTS: Concur. The Defense Logistics Agency will direct the Defense National Stockpile Center, to establish requirements to set annual goals to achieve a higher volume of sales for stockpiled materials with restricted or limited markets and approved Annual Materials Plans and to develop comprehensive disposal plans.

DISPOSITION: Ongoing. ECD November 30, 1998

ACTION OFFICER: T. Frank Taylor, DNSC-DI, (703) 767-5523

FINDING B: Reporting of DSC Operations to Congress

DLA COMMENTS: Concur.

RECOMMENDATION B.1: We recommend that the Director, Defense Logistics Agency, establish guidance on the preparation of the "Strategic and Critical materials Annual Report to Congress" (the Report). As a minimum, the guidance should address:

- a Reporting the full inventory of the National Defense Stockpile (the stockpile) quantity and value, including all materials to which it holds title, regardless of physical location.
- b Presenting the sales activity and inventory changes in a consistent manner for all materials
- c Reporting reasons behind any change (greater than the rate of inflation) in the Defense National Stockpile Center operating budget
- d Reporting information concerning the effect of market prices on the value of the stockpile.
- e. Reporting information regarding funding commitments assessed against revenues received from the sale of stockpiled materials, including appropriate explanatory notes.
- f. Reporting the estimated environmental liability costs.
- g. Reporting accurately, consistently, and clearly what the Annual Materials Plan represents, excluding dollar values.
- h. Using the same sources of financial data and date for the Report as the "National Defense Stockpile Transaction Fund Financial Statement."

DLA COMMENTS: Concur. DSC will work with the Deputy Under Secretary of Defense (Industrial Affairs and Installations) to develop guidance on the preparation of the Strategic and Critical Materials Annual Report to Congress. The specific areas mentioned in the recommendation will be considered in the preparation of the guidance.

Defense Logistics Agency Comments

DISPOSITION: Ongoing. ECD: January 29, 1999

ACTION OFFICER: Mr John Babey, DNSC-SR, (703) 767-5523

RECOMMENDATION B.2: We recommend that the Administrator, Defense National Stockpile Center, request the Under Secretary of Defense (Comptroller) to fully fund (via set-asides) known environmental liability costs.

DLA COMMENTS: Concur. DNSC has requested full funding of all known environmental liability costs in the Defense Logistics Agency (DLA) FY 2000 and 2001 Budget Estimate Submission (BES).

DISPOSITION: Considered Complete.

ACTION OFFICER: Mr. Philip Boswell, DNSC-DF, (703) 767-5524

REVIEW: Mr Richard J. Connolly, Administrator, (703) 767-5525

COORDINATION: Sharon Entsminger, DDAI, (703) 767-6267

DLA APPROVAL:



E.R. CHAMBERLIN
Rear Admiral, SC, USN
Deputy Director

OCT - 7 1998

Evaluation Team Members

The Readiness and Logistics Support Directorate, Office of the Assistant Inspector General for Auditing, DoD, produced this report.

Shelton R. Young
Raymond D. Kidd
Albert Putnam
Commander Robert Szabo, U.S. Navy
Joseph Maurer
Andrew Forte
Elizabeth A. Denny